

REACT

COMPRISED OF:
A. FINKL & SONS, CO.
AUX SABLE LIQUID PRODUCTS, LP
THE CITY OF CHICAGO
COMMERCE ENERGY, INC.
FLINT HILLS RESOURCES, LP
FUTUREMARK PAPER COMPANY
INTEGRYS ENERGY SERVICES, INC.
INTERSTATE GAS SUPPLY OF ILLINOIS, INC.
THE METROPOLITAN WATER RECLAMATION DISTRICT
OF GREATER CHICAGO
PDV MIDWEST REFINING LLC
UNITED AIRLINES, INC.
WELLS MANUFACTURING, INC.

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1

STATE OF ILLINOIS

2

BEFORE THE ILLINOIS COMMERCE COMMISSION

3

Commonwealth Edison Company

:

:

: **ICC Docket No. 10-0467**

Proposed general increase in electric rates

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4

5

DIRECT TESTIMONY OF JEFFREY MEROLA

6

I.

7

INTRODUCTION AND QUALIFICATIONS

8

Q. Please state your name, title, and business address.

9

A. My name is Jeffrey Merola. I am a Vice President of Intelometry, Inc. My

10

business address is 3838 North Sam Houston Parkway East, Suite 180, Houston,

11

Texas 77032.

12

13

Q. On whose behalf are you testifying?

14

A. I am testifying on behalf of the coalition to Request Equitable Allocation of Costs

15

Together (“REACT”).¹ REACT brings together some of the largest and most

16

prominent industrial, commercial, and governmental energy users in the Chicago

17

area, together with retail energy suppliers (“RESs”) that are interested in

18

providing service to customers in the service territory of Commonwealth Edison

19

Company (“ComEd”). REACT actively participated in all phases of the

¹ The REACT members include: A. Finkl & Sons, Co.; Aux Sable Liquid Products, LP; The City of Chicago; Commerce Energy, Inc.; Flint Hills Resources, LP; FutureMark Paper Company; Integrys Energy Services, Inc.; Interstate Gas Supply of Illinois, Inc.; The Metropolitan Water Reclamation District of Greater Chicago; PDV Midwest Refining LLC; United Airlines, Inc.; and Wells Manufacturing Company. The opinions herein do not necessarily represent the positions of any particular member of REACT.

predecessor cases to the instant proceeding -- that is, ICC Docket No. 07-0566 (the "2007 ComEd Rate Case") and ICC Docket No. 08-0532 (the "2008 Special Investigation Proceeding") -- and presented substantial expert testimony and argument in support of fair, accurate, and equitable rate design that (1) avoids penalizing the largest customers based upon a fundamentally flawed cost study; and (2) allocates Customer Care Costs in a manner that respects principles of cost causation, encourages the development of retail electric competition for residential customers, and treats all customers fairly.

Q. Please describe the work that Intelometry, Inc. performs.

A. Intelometry provides software products and consulting services to meet the needs of the energy industry. Our products and services address the needs of energy marketers, utilities, government agencies, and commercial and industrial energy users across North America. We employ our business and technology depth and breadth to simplify complex problems and deliver a solution or product that is practical and sustainable.

Q. Please summarize your current position and duties at Intelometry, Inc.

A. As a Vice President, I lead Intelometry's Business Services Practice, which focuses on wholesale and retail marketing in the electric power and natural gas industries. As part of my work, I provide management consulting expertise related to the operations and management of retail energy supply organizations.

43 **Q. Please summarize your educational background and professional experience.**

44 A. I received my BE degree with a major in electrical engineering from Youngstown
45 State University in 1990. During my career, I have been deeply involved with the
46 deregulation of the power industry throughout the United States.

47

48 Before joining Intelometry, I worked for Econ One Research, Inc. in Houston,
49 Texas from 2002 to 2004, where I was responsible for the creation and
50 development of an energy consulting practice. I advised clients on market
51 strategy and business operations, and I testified on behalf of clients as an energy
52 expert in various proceedings before a federal court, the American Arbitration
53 Association, state regulatory commissions, and the Federal Energy Regulatory
54 Commission. Prior to that, in 2001, I worked for Enron Wholesale Services as a
55 Manager of Logistics. In that role, I coordinated the functions required to deliver
56 physical power to Enron Energy Services' customers throughout the Northeast,
57 Midwest, and Texas. I also worked for Enron Energy Services as a Manager of
58 Commodity Structuring for the Midwest region. In that role, I developed and
59 implemented new power products for commercial and industrial customers.

60

61 Prior to joining Enron in December 2000, I worked for Allegheny Energy in
62 numerous roles for approximately ten years. My last position at Allegheny was
63 Manager of Product Pricing and Business Development. In that role, I was
64 responsible for the business functions supporting sales to retail power customers
65 in the mid-Atlantic and Midwest regions. These functions included portfolio

66 management, pricing and product development, marketing, and business
 67 development. I also participated in several committees and working groups
 68 involved with the development of market rules within PJM and the Midwest. My
 69 resume is attached as REACT Exhibit 2.1 to this testimony, and includes a list of
 70 proceedings in which I have provided expert testimony.

71

72 **Q. Have you testified previously before the Illinois Commerce Commission**
 73 **(“Commission”)?**

74 A. Yes, in the 2007 ComEd Rate Case (ICC Docket No. 07-0566) and the 2008
 75 Special Investigation Proceeding (ICC Docket No. 08-0532), I submitted direct
 76 and rebuttal testimony on behalf of REACT regarding ComEd’s allocation of
 77 supply-related costs to its distribution rates.

78

79 **Q. Are you incorporating any of your previous testimony by reference?**

80 A. Yes. I am incorporating my testimony from the 2007 ComEd Rate Case and the
 81 2008 Special Investigation Proceeding. My Corrected Direct and Corrected
 82 Rebuttal Testimony, and the exhibits thereto submitted into evidence in the 2007
 83 ComEd Rate Case are incorporated herein as if they were attached in REACT
 84 Exhibits 2.7 and 2.8, respectively.² My Direct and Corrected Rebuttal Testimony,
 85 and the exhibits thereto submitted into evidence in the 2008 Special Investigation

² In the 2007 ComEd Rate Case (ICC Docket No. 07-0566), my Corrected Direct Testimony (REACT Corrected Exhibit 3.0) with accompanying exhibit (REACT Exhibit 3.1), were filed on ICC eDocket on May 6, 2008. My Corrected Rebuttal Testimony (REACT Corrected Exhibit 7.0) with accompanying exhibits (REACT Exhibits 7.1-7.4), were filed on ICC eDocket on May 6, 2008.

86 Proceeding are incorporated herein as if they were attached in REACT 2.9 and
 87 2.10, respectively.³

88

89 **II.**

90 **PURPOSE OF TESTIMONY AND GENERAL CONCLUSIONS**

91 **Q. What is the purpose of your testimony?**

92 A. I have been asked by REACT to review and comment on ComEd's recommended
 93 allocation of Customer Care Costs to the supply function as presented in the
 94 Supplemental Direct Testimony of ComEd witnesses Ronald E. Donovan, P.E.,
 95 Lawrence S. Alongi, and Robert Garcia.

96

97 **Q. What are Customer Care Costs?**

98 A. Customer Care Costs represent those costs ComEd incurs to provide customer
 99 service for its delivery and supply customers. Customer service includes the
 100 calculation and generation of bills, tracking and maintaining customer
 101 information, mailing of bills, responding to customer phone calls, metering
 102 services, payment processing, credit and collections, and general customer
 103 relations activities. This includes not only the costs associated with direct
 104 customer interaction but also the cost of computer systems and infrastructure to
 105 support these business activities.⁴

106

³ In the 2008 Special Investigation Proceeding (ICC Docket No. 08-0532), my Direct Testimony (REACT Exhibit 2.0) with accompanying exhibits (REACT Exhibits 2.1-2.7), were filed on ICC eDocket on May 22, 2009. My Corrected Rebuttal Testimony (REACT Corrected Exhibit 4.0) with accompanying exhibits (REACT Exhibits 4.1-4.5), were filed on ICC eDocket on October 13, 2009.

⁴ ComEd Ex. 19.0R, Donovan Revised Supplemental Direct Testimony at 5-6:112-121.

107 **Q. Will the accurate allocation of Customer Care Costs between the supply**
 108 **function and the delivery services function affect ComEd's overall cost**
 109 **recovery?**

110 A. No. REACT is not making an argument about allocation that will result in
 111 ComEd recovering less than 100% of the Commission-approved costs that
 112 ComEd is entitled to recover. REACT merely seeks accurate allocation of
 113 Customer Care Costs, so that there is no anti-competitive cross-subsidization and
 114 resulting false price signals.

115
 116 **Q. Has the Commission addressed Customer Care Costs before?**

117 A. Yes. In the 2007 ComEd Rate Case, REACT questioned ComEd's failure to
 118 allocate Customer Care Costs in a manner that fairly reflected the portion of
 119 Customer Care Costs associated with the supply function. REACT presented
 120 evidence and argument demonstrating that ComEd had misallocated a substantial
 121 amount of Customer Care Costs. That is, REACT demonstrated that ComEd
 122 attributed certain Customer Care Costs that are supply-related to the delivery
 123 services function. This misallocation artificially increased delivery services rates
 124 -- a classic example of an anti-competitive cross-subsidization.

125
 126 The Commission's Order in the 2007 ComEd Rate Case found:

127 The Commission believes that some percentage of
 128 Customer Care Costs may well be attributable specifically
 129 to bundled supply customers. This allocation could
 130 substantially reduce costs assigned to distribution
 131 customers while increasing bundled supply rates. The
 132 Commission believes that it is reasonable to investigate the

133 allocation of Customer Care Costs.⁵
 134 Accordingly, in its Initiating Order for the 2008 Special Investigation Proceeding
 135 (issued on the same day as the final Order in the 2007 ComEd Rate Case), the
 136 Commission directed ComEd to “provide an updated cost of service study that ...
 137 analyzes the cost of providing Customer Care to a customer taking supply from an
 138 alternative supplier versus the cost of providing Customer Care to a customer
 139 taking supply from ComEd . . . ”⁶

140

141 **Q. Did you testify on REACT’s behalf in the 2008 Special Investigation**
 142 **Proceeding?**

143 A. Yes. I provided detailed testimony based on the proper identification and
 144 allocation of Customer Care Costs.

145

146 **Q. What view did the Commission ultimately express with respect to ComEd’s**
 147 **allocation of Customer Care Costs in the 2008 Special Investigation**
 148 **Proceeding (ICC Docket No. 08-0532)?**

149 A. The Commission expressed significant concern that ComEd had not appropriately
 150 allocated Customer Care Costs to the supply function stating:

151 ComEd’s proposal allocates less than one percent of its
 152 Customer Care Costs to supply based on an avoided cost
 153 analysis. If the Commission’s goal is to assign costs to the
 154 cost causers, it is difficult to imagine that less than 1% of
 155 ComEd’s Customer Care Costs are caused by supply
 156 related matters. ComEd does not explain why an avoided
 157 cost study is used for these costs and for every other cost an

⁵ ICC Docket No. 07-0566, Final Order dated September 10, 2008 at 207-208.

⁶ Initiating Order, Commonwealth Edison Company, Investigation of Rate Design Pursuant to Section 9-250 of the Public Utilities Act, ICC Docket No. 08-0532 at 2 (September 10, 2008). (“Initiating Order”).

embedded cost study is done.⁷

Q. Does ComEd recommend a reasonable allocation of Customer Care Costs to the supply function in this proceeding?

A. No. Even after the Commission raised substantial questions about ComEd's approach and conclusions in two separate proceedings, and specifically found in the 2008 Special Investigation Proceeding that ComEd's analysis was "difficult to imagine," ComEd continues to argue that virtually zero Customer Care Costs should be allocated to the supply function and repeats its avoided cost analysis, referred to as the "Switching Study," in this proceeding.⁸ The Commission obviously found that approach questionable in the 2007 ComEd Rate Case and certainly did not find that approach compelling in the 2008 Special Investigation Proceeding. ComEd provides no reason why the Commission should find it persuasive now.

⁷ ICC Docket No. 08-0532, Final Order dated April 21, 2010, at 67.

⁸ ComEd allocates \$1.4 million in Customer Care Costs to supply administration in this proceeding (see ComEd's Exhibit 22.1, Schedule 1a, Page 13 of 21, Line 215, column "Supply Administration") out of a total of \$438.5 million in Customer Care Costs (REACT Exhibit 2.4), or less than 3/10 of a percent.

173 **Q. What did the Commission direct ComEd to do in this proceeding to**
 174 **appropriately allocate Customer Care Costs to the supply function?**

175 A. The Commission directed ComEd “to perform an embedded cost study for these
 176 [customer care] costs and present it for consideration and discussion in its next
 177 rate proceeding.”⁹

178

179 **Q. Did ComEd perform a complete embedded cost study to allocate Customer**
 180 **Care Costs in this proceeding?**

181 A. No. In its initial filing in this case, ComEd did not file any studies on Customer
 182 Care Cost allocation. Well after its initial filing, ComEd presented
 183 “supplemental” testimony that includes a purported analysis of ComEd’s
 184 embedded costs of customer care; ComEd refers to this study as the “Allocation
 185 Study.”¹⁰ ComEd’s Allocation Study, however, contains key errors that cause it
 186 to be an incomplete and inaccurate embedded cost study.

187

188 **Q. What errors have you found in ComEd’s Allocation Study?**

189 A. There are two key errors ComEd has made in its Allocation Study that render it
 190 useless as an embedded cost study for the purposes of allocating Customer Care
 191 Costs. The key errors are:

192 • ComEd included only “direct O&M” costs in the analysis, instead of
 193 analyzing ComEd’s total cost to serve. By doing so, ComEd
 194 automatically allocated \$259.1 million in Customer Care Costs to the
 195 delivery function without performing any analysis of those costs.¹¹ Thus,
 196 ComEd artificially reduced the possible “pie” of Customer Care Costs

⁹ See ICC Docket No. 08-0532, Final Order dated April 21, 2010, at 68.

¹⁰ ComEd Ex. 19.0R, Donovan Revised Supplemental Direct Testimony at 1:13-15.

¹¹ See REACT Exhibit 2.2.

from \$435.3 million to \$176.2 million. In other words, ComEd sliced about 60% of its total cost to serve right off the top, and then performed its Allocation Study on the remaining 40%.

- ComEd developed implausible allocators to artificially allocate too low of a percentage of Customer Care Costs to the supply function. ComEd's analysis results in an allocation of just 7.1% of ComEd's total cost to serve to the supply function¹² while adjusting for a few key allocators to be more reasonable would increase this allocation to 20.7% of the total cost to serve.¹³

Q. Have you estimated the impact of ComEd's errors in its Allocation Study?

A. Yes. Correcting for ComEd's errors (i.e., by including ComEd's total cost to serve and by adjusting key allocators to be more reasoned), I have determined that the total allocation of Customer Care Costs should be **at least** \$90.8 million instead of ComEd's allocation of \$31.2 million.¹⁴

Q. Assuming the Commission adopts your recommendation, should any of the Customer Care Costs allocated to the supply function be automatically recovered through Rider PORCB as ComEd has suggested?¹⁵

A. No. ComEd has provided no justification or quantification of its Customer Care Costs as it relates to Rider PORCB in this proceeding. Any allocation of Customer Care Costs to Rider PORCB should be addressed as part of ICC Docket No. 10-0138 and cost recovery should be in accordance with the methods approved by the Commission in that proceeding.

¹² See REACT Exhibit 2.4.

¹³ See REACT Exhibit 2.5.

¹⁴ See REACT Exhibit 2.5.

¹⁵ See ComEd Ex. 24.0R, Robert Garcia Revised Supplemental Direct Testimony, 11:245-12:249.

222 **Q. Please summarize your conclusions.**

223 A. Despite the Commission's clearly stated concerns about the legitimacy of
 224 ComEd's position that less than 1% of Customer Care Costs have been allocated
 225 to the supply function, ComEd continues to present and endorse the same
 226 conclusion through its Switching Study in this proceeding. The Commission
 227 should continue to dismiss this argument as it has done in the past.

228

229 ComEd's attempt to perform an embedded cost of service study on Customer
 230 Care Costs, as directed by the Commission, should also be dismissed by the
 231 Commission as it ignores nearly 60% of ComEd's total Customer Care Costs and
 232 allocates the remaining 40% of costs between delivery and supply functions
 233 utilizing a number of implausible allocators.

234

235 The Commission should summarily reject ComEd's Switching Study approach,
 236 and should direct ComEd to correct the errors in its Allocation Study. I have
 237 calculated that in doing so, ComEd's allocation of Customer Care Costs to the
 238 supply functions should increase from \$31.2 million to at least \$90.8 million, a
 239 nearly three-fold difference.¹⁶

¹⁶ See REACT Exhibit 2.5.

III.

COMED FAILED TO PROPERLY ALLOCATE CUSTOMER CARE COSTS

Q. Please summarize the approach that ComEd took to allocating Customer Care Costs between the delivery and supply function.

A. ComEd began by including 2009 test year costs for the following categories for departments that had greater than \$100,000 per year in costs:

- billing -- computation and data management;
- bill issue and processing;
- customer information; and
- metering services.¹⁷

Q. Did ComEd include all costs associated with each category?

A. No. ComEd included only what it characterized as direct operating and maintenance (“O&M”) costs.¹⁸

Q. Why did ComEd include only direct O&M costs in its analysis?

A. ComEd has not offered a viable reason for limiting the analysis to only direct O&M costs. In answer to a REACT data request, ComEd stated that it was based on ComEd’s interpretation of the Commission’s definition of “these costs” from the Order in the 2008 Special Investigation Proceeding.¹⁹ Specifically, ComEd

¹⁷ See ComEd Ex. 19.0R, at 4:90-5:92.

¹⁸ See ComEd Ex. 19.0R at 4:79-81.

¹⁹ See ComEd Response to REACT Data Request 2.27. That Data Request Response and all other ComEd Data Request Responses to REACT and Commission Staff Data Requests cited in this testimony are attached to this testimony in REACT Ex. 2.6, which includes, in numerical order, all cited ComEd Data

quoted the Commission when it ordered ComEd “. . . to file an embedded cost of service study for **these costs** and to also include the results of its avoided cost study.”²⁰

Q. Does ComEd’s explanation make sense in the context of the Commission’s order in the 2008 Special Investigation Proceeding?

A. No. It is clear that the Commission generically referred to “these costs” many times in its order in relation to Customer Care Costs as a whole -- and it is clear that the Commission was specifically *not* endorsing or adopting in any way, shape, or form ComEd’s artificially narrow interpretation of the costs at issue. In fact, the Commission used virtually the same phrase two paragraphs before the statement selected by ComEd directly after referring to my assessment of Customer Care Costs in the Rate Design Investigation which **did not** restrict the analysis only to direct O&M costs. In full, that paragraph stated:

For REACT, after Mr. Merola assigned costs that he believes are clearly delivery to the delivery customer, he took the remaining costs and divided them 50-50 between delivery and supply. Although this is an arbitrary allocation, REACT’s methodology is consistent with an embedded cost methodology. Because the record does not contain information to calculate the appropriate allocator, this is an issue appropriate for a subsequent rate proceeding. To facilitate the further analysis of these issues, ComEd is directed to perform an embedded cost study for these costs and present it for consideration and discussion in its next rate proceeding.²¹

Request Responses to REACT Data Requests, followed by all cited ComEd responses to Staff PR Data Requests.

²⁰ ICC Docket No. 08-0532, Final Order dated April 21, 2010, at 69 (emphasis added.)

²¹ *Id.* at 68.

285 Nothing in that paragraph suggests some artificial limitation on the scope of costs
286 that ComEd was being directed to examine and fairly allocate. On the contrary,
287 the Commission's reference to "these costs" in the last sentence of that paragraph
288 plainly refers to the "costs" that I was referring to, as described in the first
289 sentence of the paragraph. And to be clear, I have never advocated that the costs
290 that should be allocated should only include direct O&M costs.

291

292 **Q. After artificially limiting the total Customer Care Costs it felt should be**
293 **included in the analysis to just direct O&M costs, what did ComEd do next?**

294 A. ComEd began by excluding from further analysis two categories of costs --
295 Metering Services and Advertising -- as ComEd deemed them to be related solely
296 to delivery service.²²

297

298 **Q. Do you agree with ComEd that Advertising costs should be fully allocated to**
299 **the delivery function?**

300 A. Yes. Based on ComEd's explanation of the nature of the advertising costs and the
301 information I have seen up to this point,²³ it appears that ComEd supports
302 advertising only for the delivery portion of the business.

303

²² See ComEd Ex. 19.0R at 6:126-127.

²³ See *id.* at 7:142-148.

304 **Q. Do you agree with ComEd that Metering Services costs should be fully**
 305 **allocated to the delivery function?**

306 A. Because Metering Services are provided for all customers regardless of the
 307 customer's choice of a generation supplier, it is reasonable to recover these costs
 308 as part of the delivery services rates. This is consistent with the position I took in
 309 the 2008 Special Investigation Proceeding when this issue came up. Oddly,
 310 ComEd attacked my position on this point during the course of the 2008 Special
 311 Investigation Proceeding, even though I was essentially agreeing with ComEd
 312 about the treatment of this category of costs. Notwithstanding that attack, I
 313 continue to believe that it is reasonable to recover Metering Services-related costs
 314 as part of the delivery services rates.

315

316 **Q. After removing the Metering Services and Advertising costs, how does**
 317 **ComEd allocate the remaining costs between the delivery and supply**
 318 **functions?**

319 A. ComEd uses two different methodologies, an avoided cost methodology that
 320 ComEd refers to as the Switching Study, and what ComEd characterizes as an
 321 embedded cost methodology that ComEd refers to as the Allocation Study.²⁴

322

323 **Q. How did ComEd perform its Switching Study?**

324 A. ComEd's Switching Study is nearly identical to the approach ComEd took to
 325 perform its study in the 2008 Special Investigation Proceeding. That is, ComEd

²⁴ See *id* at 7:161-163.

uses the same methodology that reached a conclusion that the Commission previously characterized as being “difficult to imagine.”²⁵

Similar to the ComEd’s study in the 2008 Special Investigation Proceeding, ComEd purports to examine whether or not ComEd’s Customer Care Costs will change if 1%, 10% or 100% of ComEd’s customers choose supply from a Retail Electric Supplier (“RES”).²⁶

Just as it concluded in the 2008 Special Investigation Proceeding, the Commission should reject the conclusion of ComEd’s Switching Study as highly unpersuasive and questionable. The Commission should, rather, insist on an embedded cost of service methodology that allocates costs associated with customer care activities that support both the delivery and the supply functions to both the delivery and supply functions.

Q. What are the key reasons why the Switching Study should be rejected?

A. The reasons for rejecting the Switching Study have not changed since it was presented in the 2008 Special Investigation Proceeding. They include:

- Customer Care Costs are common to the delivery and supply function. There is no doubt that a significant portion of ComEd’s Customer Care Costs support both the delivery and supply function. Therefore, proper cost allocation demands that these costs be allocated to both functions, not improperly allocated only to the delivery function.

²⁵ See, e.g., ICC Docket No. 08-0532, Final Order dated April 21, 2010, at 67.

²⁶ See Ex. 19.0R at 8:167-169.

- It reaches an implausible conclusion. As the Commission recognized in the 2008 Special Investigation Proceeding,²⁷ the Switching Study results in an allocation of nearly zero Customer Care Costs to the supply function. It is implausible that ComEd's Customer Care Costs would not be reduced at all if it were not providing supply services to customers and it is further implausible that nearly zero Customer Care Costs are associated with its supply function.
- It is based on hypothetical scenarios that are a long way from occurring. The Switching Study is based on the hypothetical scenario of 10% and 100% switching. ComEd currently has roughly 1%²⁸ of its customers being supplied by a RES and does not forecast 10% or 100% switching in the foreseeable future.²⁹ No one knows what the drivers of ComEd's Customer Care Costs will be under 10% or 100% switching because they have never even come close to this scenario. ComEd's analysis should be dismissed, if for no other reason than it is pure speculation.

Q. How did ComEd perform its Allocation Study?

A. ComEd developed what it referred to as "base allocators" to allocate Customer Care Costs between the delivery and the supply function. At a high-level, ComEd characterizes the creation of four base allocators including:

- **Direct Allocation** -- allocates 100% to the delivery function.
- **Company Revenue Allocation** -- allocates costs based on the percentage of ComEd revenue that is attributable to delivery (38.4%) compared to supply (61.6%).
- **Bill Calculation Allocation** -- allocates cost related to determining or explaining bills 75% to delivery and 25% to supply, based on the number of line items on a typical bill.
- **Bill Print, Mailing and Imaging Allocation** -- allocates cost related to the bill printing, mailing and imaging costs 83% to delivery and 17% to supply based on the amount of space on the bill related to delivery.³⁰

²⁷ See ICC Docket No. 08-0532, Final Order dated April 21, 2010, at 67.

²⁸ See ComEd Ex. 19.0R at 8:169.

²⁹ See ComEd Response to Staff Data Requests PR 11.08 and PR 11.05; ComEd Ex. 19.0R at 8:174-175.

³⁰ See ComEd Ex. 19.0R at 9:187-214.

381

382 **Q. Did ComEd perform the allocation of all of its costs strictly using these four**
 383 **allocators?**

384 A. No. By examining ComEd's workpapers, one can determine that ComEd actually
 385 used 24 different cost allocators.³¹

386

387 **Q. Does ComEd's use of so many different allocators indicate that it has done a**
 388 **thorough and comprehensive job of analyzing how costs should be accurately**
 389 **allocated to the delivery and supply functions?**

390 A. No. While ComEd's analysis may seem complex, it fails to achieve the
 391 fundamental task that the Commission required in its Order in the 2008 Special
 392 Investigation Proceeding -- appropriate allocation of Customer Care Costs
 393 between the delivery and supply function. In fact, ComEd's approach results in
 394 several implausible conclusions.

395

396 For starters, in developing all of the allocators, ComEd began by asking the
 397 **wrong question.** ComEd asked what percentage of direct O&M costs (not the
 398 total cost to serve) should be allocated to the delivery and supply function. In
 399 doing so, ComEd failed to ask how the majority of its Customer Care Costs

³¹ The use of these allocators can be gleaned by reviewing ComEd's response to IIEC Data Request 1.04, filename "IIEC 1.04_Attach123.xls". The twenty-four allocators include: Metering Services Allocator, Call Center Allocator, System Billing Delivery Allocator, Customer Allocations Allocator, Large Customer Services Allocator, Revenue Management Allocator, CIMS Allocator, SIR Allocator, Field and Metering Services Allocator, Advertising Allocator, Customer Satisfaction Survey Allocator, Energy Efficiency Allocator, Demand Response Allocator, Revenue Protection Allocator, Customer Relations Allocator, IT Licensing Allocator, IT General Allocator, Non-Tariff Marketing Allocator, Custom Derived Allocator, Revenue Allocator, ESSD Allocator, AMI Allocator, System Billing Allocator, and the Bill Calculation Allocator.

400 should be allocated to the delivery and supply functions. This approach amounted
 401 to ComEd artificially shrinking the size of the “pie” before deciding how to
 402 allocate that “pie” between delivery services and supply functions.

403

404 **Q. Aside from the fundamental error of failing to identify the full amount that**
 405 **should be included in the allocation decision, are there other issues with**
 406 **ComEd’s development of base allocators?**

407 A. Yes. Many of the base allocators seem to have little to do with the costs they are
 408 purportedly allocating. I will speak specifically to these later in my testimony.

409

410 **Q. What conclusion does ComEd reach with respect to the allocation of**
 411 **Customer Care Costs to the delivery and supply functions?**

412 A. Despite the Commission’s stated concern with ComEd’s Switching Study in the
 413 2008 Special Investigation Proceeding, ComEd continues to stick with the same
 414 flawed approach, which leads it to the same flawed conclusion -- that less than
 415 1% of ComEd’s Customer Care Costs should be allocated to the supply
 416 function.³² Yet, ComEd has failed to provide any new basis to reach this
 417 conclusion, and therefore the conclusion continues to be -- in the words of the
 418 Commission -- “difficult to imagine.”

³² See Note 7 *supra*.

IV.

COMED FAILED TO INCLUDE ALL CUSTOMER CARE COSTS

Q. By including only direct O&M costs in its analysis of Customer Care Costs, how much has ComEd excluded from its analysis?

A. ComEd has excluded a total of \$259.0 million in costs from its customer care analysis, excluding nearly 60% of the Customer Care Costs that make up ComEd's total cost to serve. Even assuming that metering services are properly removed from the analysis, ComEd has still excluded \$144.1 million from the remaining Customer Care Costs.³³ Again, this amounts to ComEd artificially shrinking the "pie" before determining how to allocate the "pie" between delivery and supply functions.

Q. What types of costs make up the \$144.1 million in non-metering related costs ComEd has excluded?

A. ComEd excluded \$101.6 million in administrative and general expenses, \$1.2 million in customer accounts and service expense, \$16.7 million in depreciation expenses, \$6.4 million in taxes other than income, and \$18.2 million in return on its rate base.³⁴

³³ See REACT Ex. 2.2.

³⁴ See REACT Ex. 2.3.

438 **Q. What is the nature of the administrative and general expenses ComEd has**
 439 **excluded?**

440 A. ComEd has excluded \$101.6 million in administrative and general expenses.
 441 These expenses relate to the compensation of officers, executives, and other
 442 employees of the utility,³⁵ office supplies and expenses,³⁶ fees and expenses of
 443 professional consultants and others for general services,³⁷ employee pensions,³⁸
 444 insurance,³⁹ property maintenance,⁴⁰ regulatory commission expense,⁴¹ general
 445 labor and expenses,⁴² and property rent.⁴³

446

447 **Q. Is there any reason for ComEd to allocate none of these Customer Care**
 448 **Costs to the supply function?**

449 A. No. In its ECOSS, ComEd has shown all of these costs are clearly associated
 450 with customer care. ComEd has provided no reasonable explanation for why
 451 these substantial Customer Care Costs should be 100% allocated to the delivery
 452 function.

453

³⁵ See ComEd Response to REACT Data Request 4.16.

³⁶ See ComEd Response to REACT Data Request 4.17.

³⁷ See ComEd Response to REACT Data Request 4.19.

³⁸ See ComEd Response to REACT Data Request 4.20.

³⁹ See ComEd Response to REACT Data Request 4.21 and 4.22.

⁴⁰ See ComEd Response to REACT Data Request 4.23.

⁴¹ See ComEd Response to REACT Data Request 4.24.

⁴² See ComEd Response to REACT Data Request 4.25.

⁴³ See ComEd Response to REACT Data Request 4.26.

454 **Q. What is the nature of the customer accounts and services expense ComEd**
 455 **has excluded?**

456 A. ComEd has excluded \$1.2 million in customer accounts and service expense.
 457 These costs are related to pro forma adjustments in Customer Care Costs.

458

459 **Q. Is there a reason for ComEd to allocate none of these pro forma adjustments**
 460 **to the delivery function?**

461 A. No; as ComEd witness Kathryn M. Houtsma discusses, pro forma adjustments
 462 reflect known and measurable changes in plant investment, operating revenues, or
 463 expenses.⁴⁴ In this case, these are known and measurable changes in Customer
 464 Care Costs, there is no reason to automatically assign them only to the delivery
 465 function.

466

467 **Q. What is the nature of the depreciation expenses ComEd has excluded?**

468 A. ComEd has excluded \$16.7 million in depreciation expense. The vast majority of
 469 these depreciation expenses are depreciation on “intangible plant” which includes
 470 costs of capitalized software for computer systems that provide customer service
 471 and billing.⁴⁵ In addition, it includes depreciation on structures,⁴⁶ depreciation on
 472 office furniture and equipment,⁴⁷ and depreciation on vehicles⁴⁸ that are used to
 473 support customer care.

474

⁴⁴ See ComEd Ex. 6.0R at 3:61-4:63.

⁴⁵ See *id.* at 23:481-24:485.

⁴⁶ See ComEd Response to REACT Data Request 4.29 and 4.30.

⁴⁷ See ComEd Response to REACT Data Request 4.31.

⁴⁸ See ComEd Response to REACT Data Request 4.32.

475 **Q. Is there any reason ComEd should allocate none of these depreciation**
 476 **expenses to the supply function?**

477 A. No. Depreciation expenses are the direct result of ComEd's capital expenditures
 478 associated with providing customer care, mostly for computer systems. These
 479 capital expenditures have been made to support customer care for both the
 480 delivery and supply functions. Accordingly, these costs should be properly
 481 allocated to both functions.

482

483 **Q. What is the nature of the taxes other than income expenses ComEd has**
 484 **excluded?**

485 A. ComEd has excluded \$6.4 million in expenses associated taxes not related to
 486 ComEd's operating income.⁴⁹ The vast majority of these are payroll taxes.⁵⁰

487

488 **Q. Is there any reason ComEd should allocate none of its tax expenses to the**
 489 **supply function?**

490 A. No. The majority of these taxes are payroll taxes related to customer care, just as
 491 customer care related labor expenses should be allocated to both delivery and
 492 supply, so to should the associated taxes.

493

⁴⁹ See ComEd Response to REACT Data Request 4.39.

⁵⁰ See ComEd's Ex. 22.1, Schedule 1a, Page 21 of 21, Line 261.

494 **Q. Has ComEd allocated any portion of its rate base associated with customer**
 495 **care to the supply function?**

496 A. No. ComEd has not allocated any portion of its customer care rate base in its
 497 Customer Care Cost analysis.⁵¹

498
 499 **Q. By excluding rate base from its analysis, what are the total costs associated**
 500 **with its full revenue requirement that ComEd has excluded from its**
 501 **customer care analysis?**

502 A. By excluding rate base from its Customer Care Cost analysis, ComEd has
 503 allocated none of its return on rate base -- representing \$18.2 million in Customer
 504 Care Costs -- to the supply function. Again, ComEd has provided no reasonable
 505 explanation for excluding this component of its total cost of service from the
 506 Customer Care Costs that the Commission ordered it to allocate in a study.

507
 508 **Q. Please summarize the total impact of ComEd limiting its Customer Care**
 509 **Cost analysis to only direct O&M costs.**

510 A. By excluding administrative and general expenses, depreciation expenses, taxes
 511 other than income and return on rate base in its analysis; ComEd has excluded
 512 \$259.1 million in Customer Care Costs from its analysis.⁵² Adjusting only for
 513 this error, ComEd's allocation of Customer Care Costs to the supply function
 514 would nearly double, increasing from \$33.9 million to \$66.1 million.⁵³ ComEd

⁵¹ See ComEd Response to REACT Data Request 4.43, 4.44, and 4.45.

⁵² See REACT Ex. 2.2.

⁵³ See REACT Ex. 2.4.

515 has offered no viable explanation for excluding these significant costs in its
516 analysis.

517

518 **V.**

519 **THE COMMISSION SHOULD REJECT COMED’S IMPROPERLY DESIGNED**
520 **ALLOCATORS**

521 **Q. You mentioned earlier that ComEd developed its allocators by asking the**
522 **wrong question -- that is, how only direct O&M costs should be allocated**
523 **between the delivery and supply function. How should ComEd have**
524 **approached the development of allocators?**

525 A. Direct O&M costs are only a small component of ComEd’s overall Customer
526 Care Costs as I have discussed earlier. To appropriately allocate all Customer
527 Care Costs between delivery and supply, ComEd should have developed
528 reasonable allocators based on the drivers of all Customer Care Costs, not just
529 direct O&M.

530

531 **Q. Are there other issues with ComEd’s allocators?**

532 A. Yes. Several of ComEd’s allocators result in implausible conclusions. For
533 example:

- 534 • The billing calculation allocator assumes that the costs associated with
535 calculating a bill are somehow related to the number of line items on a
536 bill;⁵⁴
- 537 • The system billing allocator allocates the cost associated with mailing a
538 bill based on the amount of space “delivery” related items take up on the
539 bill;⁵⁵

⁵⁴ See ComEd Ex. 19.0R at 9:197-204.

540 • IT cost allocation is based on several allocators that have little to do with
541 IT system development; such as which department system users are in;
542 and

543 • For the Large Customer Services department; ComEd assumed that less
544 than half a person out of 79 people have anything to do with supply.

545

546 **Q. Did you adjust all of ComEd's allocators to correct for the issues you have**
547 **presented?**

548 A. No. Given the lack of data provided by ComEd, I adjusted only a few key
549 allocators to reflect a more reasonable allocation of Customer Care Costs between
550 delivery and supply. If ComEd were to provide more complete information to the
551 Data Requests that REACT has propounded, I would be able to perform
552 supplemental analysis to further refine the allocations that should be applied to
553 Customer Care Costs.

554

555 **Q. Based on the limited information provided, which allocators did you adjust?**

556 A. I adjusted four key allocators used by ComEd: the billing calculation allocator;
557 the system billing allocator; the CIMS users allocator; and the IT general
558 allocator.

559

560 **Q. How did ComEd develop its billing calculation allocator?**

561 A. ComEd purportedly allocates significant Customer Care Costs based on the
562 percentage of costs related to bill calculation for supply versus delivery.
563 However, to determine the allocation of these costs, ComEd simply examines the

⁵⁵ See *id.* at 9:205-214.

number of line items on a bill and allocates 75% of the applicable costs to delivery because 9 of the 12 line items on the bill ComEd examined are “delivery related”.⁵⁶ By this logic, ComEd could reduce billing costs by 92% by calculating the same bill, but by only providing one line item on the invoice depicting total charges incurred.

ComEd provides no viable explanation for why the number of line items that show on a bill correlates in any way with the costs associated with computing delivery or supply charges. Further, when asked if its evaluation would change if ComEd picked a bill for an hourly rate calculation, such as Rate BES-H -- Basic Electric Service -- Hourly Energy Pricing (“Rate BES-H”), ComEd said no -- because the number of line items would remain the same.⁵⁷ That answer amounts to proof that the methodology ComEd employed resulted in a plainly inaccurate conclusion that bears little or no relation to reality. Clearly, there is more involved in calculating a bill associated with an hourly rate like Rate BES-H than calculating a bill associated with Rate BES. For example, Rate BES-H has numerous components that must be frequently computed including the Capacity Charge, Hourly Energy Charge, PJM Services Charge, Miscellaneous Procurement Components Charge and the Hourly Purchased Electricity Adjustment Factor.⁵⁸ ComEd’s approach simply fails to account for reality.

⁵⁶ See *id.* at 9:197-204.

⁵⁷ See ComEd Response to REACT Data Request 3.05.

⁵⁸ See ComEd’s Schedule of Rates for Electric Service Original Sheets No. 29-46 (accessed at https://www.comed.com/Documents/Customerservice_RateInfo/Ratebook.pdf.)

585 **Q. Did ComEd examine other methods to allocate billing calculation costs that**
 586 **may have been more relevant?**

587 A. Yes. ComEd considered counting the lines of code in CIMS or computing
 588 processing time, however, ComEd dismissed those approaches.⁵⁹

590 **Q. How did you adjust ComEd's billing calculation allocator?**

591 A. Given the significant investment by ComEd in systems, people, and infrastructure
 592 it is far more reasonable to assume that these investments and costs are equally
 593 used to support calculation of both the supply and delivery bill, so I allocated the
 594 costs evenly between delivery and supply.

596 **Q. How did ComEd develop its system billing allocator?**

597 A. ComEd computed a bill printing allocator based on the amount of space on a
 598 typical bill that ComEd deemed was supply related. ComEd then used that
 599 allocator on \$16.6 million in billing delivery related costs. However, \$14.7
 600 million of these costs are for mailing bills.⁶⁰ Even if ComEd's assessment of the
 601 percentage of the billing space related to supply was reasonable, it has nothing to
 602 do with the costs for mailing bills.

604 **Q. How did you adjust ComEd's system billing allocator?**

605 A. Similar to how ComEd allocated costs associated with revenue management,
 606 credit and collections; it would be more appropriate to allocate mailing costs

⁵⁹ See ComEd response to REACT Data Request 2.33.

⁶⁰ See ComEd's Response to IIEC Data Request 1.04, filename "IIEC 1.04_Attach123.xls", tab "Accts 901 902 903", cell F8. An excerpt from tab "Accts 901 902 903" is attached as REACT Ex. 2.11.

607 based on a revenue allocator. I made this adjustment to the calculation of the
608 system billing allocator which reduced this allocator from 80.9% to the delivery
609 function to 45.4% to the delivery function.⁶¹

610

611 **Q. How did ComEd allocate its CIMS costs?**

612 A. ComEd's CIMS costs were allocated based on ComEd's assessment of which
613 users of the system were delivery or supply-related. Since the majority of the
614 users work in the customer call center, ComEd effectively allocated CIMS costs
615 based on an allocator very similar to what they use for allocating call center costs.

616

617 **Q. What is the issue with allocating CIMS costs by user?**

618 A. In my experience, the number of users in a particular department has little to do
619 with the underlying costs of developing and maintaining the system. ComEd has
620 provided no information to support its assumption on this point.

621

622 **Q. How did you adjust the CIMS user's allocator to be more reasonable?**

623 A. CIMS clearly has a substantial role in supporting both the delivery and the supply
624 functions; therefore, in the absence of meaningful data, I allocated the CIMS costs
625 on an even split between delivery and supply.

626

⁶¹ See REACT Exhibit 2.3.

627 **Q. How did you adjust ComEd's general IT allocator?**

628 A. For many of its IT related costs, ComEd allocated the costs based on a generic
629 customer operations allocator. I modified this allocation so that general IT costs
630 are allocated based on the average allocation of other IT costs.

631

632 **Q. What is the net impact of your adjustment to the CIMS user's allocator and**
633 **the general IT allocator?**

634 A. The allocation of ComEd's general IT costs is reduced from the ComEd allocation
635 of 84.2%⁶² to the delivery function down to 54.8% to the delivery function.⁶³

636

637 **Q. What is ComEd's allocation of Customer Care Costs to the supply function**
638 **as a percentage of total Customer Care Costs?**

639 A. Under its Allocation Study, ComEd has concluded that 7.1% of ComEd's total
640 Customer Care Costs are supply related.⁶⁴

641

642 **Q. After making the adjustments to the allocators that you have identified, what**
643 **is your allocation of Customer Care Costs to the supply function?**

644 A. My net allocation of Customer Care Costs to the supply function is 20.7% of
645 ComEd's total cost to serve.⁶⁵ This allocation percentage should be applied to the
646 whole "pie" of Customer Care Costs rather than the artificially reduced "pie" that

⁶² See REACT Ex. 2.11, excerpt from ComEd's Response to IIEC Data Request 1.04, filename "IIEC 1.04_Attach123.xls", tab "Accts 901 902 903", cell G3.

⁶³ See REACT Ex. 2.5.

⁶⁴ See REACT Ex. 2.4.

⁶⁵ See REACT Ex. 2.5.

647 ComEd suggests. Thus, my analysis is that ComEd should allocate 20.7% of
648 \$435.3 million to the supply function.

649

650 **Q. Adjusting ComEd's Allocation Study to account for all Customer Care Costs**
651 **and correcting for errors in ComEd's allocators, what is the proper quantity**
652 **of Customer Care Costs that should be allocated to the supply function?**

653 A. Adjusting for ComEd's errors, **at least** \$90.8 million should be allocated to the
654 supply function.

655

656 **Q. Why do you say the allocation should be at least \$90.8 million?**

657 A. As I mentioned, given the lack of data from ComEd, I did not attempt to develop
658 an entirely new analysis. I only adjusted only the most implausible allocators that
659 were the most unreasonable reflection of how costs should be allocated between
660 delivery and supply. If the Commission forced ComEd to develop an accurate
661 and complete embedded cost study, it would likely result in an even higher
662 allocation of Customer Care Costs to the supply function.

VI.

**THE COMMISSION SHOULD REJECT ANY COMED ATTEMPT TO
ALLOCATE CUSTOMER CARE COSTS TO RIDER PORCB**

Q. What has ComEd recommended with respect to allocation of Customer Care Costs to Rider PORCB?

A. ComEd has suggested that if the Commission forces ComEd to appropriately allocate Customer Care Costs to the supply function, that such costs should be recovered through Rider PORCB.

Q. Has ComEd quantified the costs that would be recovered through Rider PORCB or provided any cost justification for recovering these costs?

A. No.

Q. Is there a separate proceeding which is addressing ComEd's recovery of Customer Care Costs for Rider PORCB?

A. Yes. I understand that this has been a subject of much debate as part of ICC Docket No. 10-0138.

Q. Should the Commission grant ComEd recovery of undefined and unjustified Customer Care Costs through Rider PORCB in this proceeding?

A. Clearly not. Recovery of these costs should be addressed through Rider PORCB and any costs recovered under Rider PORCB should be reviewed and approved by the Commission pursuant to any final order in that case.

VII.

CONCLUSION

Q. Can you please summarize your findings?

A. The Commission directed ComEd to file an embedded cost study to allocate Customer Care Costs in this case between the delivery and supply function. This issue was unresolved in the 2007 ComEd Rate Case, and in the 2008 Special Investigation Proceeding, the Commission expressed straightforward doubt about the conclusions ComEd reached regarding allocation. The Commission openly questioned ComEd's prior conclusion that less than 1% of Customer Care Costs should be allocated to supply, as "difficult to imagine".

Despite the Commission's concern, ComEd maintains the now-debunked assertion recommendation that less than 1% of Customer Care Costs should be recovered through supply rates. The Commission should continue to dismiss this argument.

First, ComEd has simply ignored nearly 60% of ComEd's total Customer Care Costs. Then, ComEd applies a number of implausible allocators to that artificially reduced amount to further reduce the amount allocated to the supply function and artificially inflate the amount allocated to the delivery function.

The Commission should reject ComEd's embedded cost and direct ComEd to correct the errors in its Allocation Study to reflect a more reasoned approach. I

710 have calculated that in doing so, ComEd's allocation of Customer Care Costs to
711 the supply function should increase from \$31.2 million to at least \$90.8 million.⁶⁶

712

713 **Q. Does this conclude your direct testimony?**

714 **A. Yes.**

⁶⁶ See REACT Ex. 2.5.